

Innovation in finance to finance innovation : supporting pro-poor entrepreneur-based innovation

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Summary

Pro-poor entrepreneur-based innovation (PEBI) is essential to the continuous development of, and poverty alleviation in, rural areas by creating employment, increasing income and providing improved goods and services. A vital factor influencing innovation and entrepreneurship is finance. However, PEBI suffers from a lack of finance, especially from the mainstream organisations that make up the core of the financial system. Instead the little support that exists comes from alternative sources at the periphery of the financial system. This substantial gap in finance for rural PEBI, which remains unexplored, is the focus of this thesis.

To start, a number of barriers to access to finance are considered, from which a conceptual framework is constructed. The framework considers the financial system as made up of a core (the banks) and a periphery, where the way knowledge flows within the system, the type of knowledge that can be accessed and accumulated, and the kind of relationships that exists matter. It is suggested that at the core, path dependence and institutional lock-in together with a closed network of similar knowledge types and a dependence on collateral rather than relationships, result in a rigid and closed system. The periphery organisations are better able to obtain and act on new knowledge (and provide finance) for a number of reasons which form the basis for a set of insufficient but necessary (INUS) condition. Accordingly, the organisations may posit the following characteristics: a dynamic and flexible approach to finance; a wide network of actors with varied knowledge; a focus on relationships; an emphasis on tacit knowledge, feedback loops and learning; an ability to innovate close to users; and a systemic and integrated approach to finance.

To test the conceptual framework, the thesis studies PEBI finance in India. Despite a relatively deep financial system, and impressive infrastructure including a huge bank branch network, rural India suffers from a lack of financial services. Decades of 'social banking' have failed to even out the distribution of financial services and today there is a noticeable bias towards urban areas. At the same time, small-scale credit for entrepreneurs and small businesses has reduced, suggesting that bank credit (from the core of the financial system) has failed to support socially relevant rural innovation and entrepreneurship.

However, in place of bank finance, a vibrant alternative sector has recently been emerging to support PEBI. There are three broad, categories: 1) micro venture capital funds that support ventures providing improved services, products or employment for the rural poor; 2) small-scale financial organisations that have gone beyond microfinance to support rural farmers and entrepreneurs; 3) organisations supporting grassroots innovation either by innovating themselves at the local level, or as incubators of rural entrepreneurs or inventors. An in-depth study of the sector is undertaken through case studies of five organisations to understand how they are able to support pro-poor entrepreneur-based innovation. These are Aavishkaar, a

micro venture capital fund; BASIX, a livelihood finance promoter; S³IDF, a social merchant bank investing in inclusive infrastructure projects; CTD, which puts together community-run business models based on existing raw material and skills; and Villgro, an incubator.

Considering the conceptual framework in light of the case studies, it is clear that each of the periphery organisations fulfil several, though not all, of the INUS conditions, and in different ways. The organisations are complementary and form an eco-system of financial support for varying types of rural PEBI. In different ways they take an integrated approach to support, including both financial and non-financial assistance. They also emphasise partnerships and networks to provide better services, acquire expertise and to influence the sector itself; continuous involvement in the investees that goes beyond a simple credit disbursement contract; and a dynamic approach, providing them with flexibility to adapt as new challenges occur. Importantly the organisations tend to link to financial institutions at the core, which is important for scaling up existing initiatives, given the vast Indian bank system.

To conclude, this thesis argues that there is a need to partially shift the focus of financial support and livelihood creation in rural areas away from microfinance, to more productive entrepreneurship and innovation that hold potential for indirectly providing more livelihoods and poverty alleviation opportunities. Three broad Government policies to achieve an enabling environment in which the PEBI support organisations can flourish include: 1) supportive regulations and an overarching PEBI Agency to coordinate departmental, national and state efforts; 2) a PEBI Fund investing in PEBI support organisations; and 3) capacity building programmes in entrepreneurship especially for MFI's, NGO's and Banks.

Samenvatting

Pro-poor entrepreneur-based innovation (PEBI) is essentieel voor de ontwikkeling van, en de armoedebestrijding op, het platteland. Het schept werkgelegenheid, verhoogt de inkomsten en zorgt voor betere goederen en diensten. Een vitale factor die van invloed is op PEBI is financiering. Echter, PEBI lijdt aan een gebrek aan financiering, met name van de banken die de kern vormen van het financiële stelsel. In plaats van te weinig steun van de kern, komt er hulp uit alternatieve bronnen aan de rand van het financiële stelsel. Deze aanzienlijke kloof in de financiering voor plattelandsontwikkeling PEBI is de focus van dit proefschrift. Eerst wordt een aantal financiële belemmeringen beschouwd, waaruit een conceptueel kader is opgebouwd. Het kader bestaat uit het financiële stelsel opgebouwd uit een kern (de banken) en een periferie, waar de manier waarop kennis stromen binnen het systeem, de aard van de kennis die kan worden benadert en verzameld, en het soort relaties dat bestaat. De periferie organisaties zijn beter in staat om nieuwe kennis op te doen en te verkrijgen, en te handelen (en te voorzien in financiën) om een aantal redenen. Deze omvatten: een dynamische en flexibele aanpak tot financiering; een breed netwerk van actoren, een nadruk op de stilzwijgende kennis en leren; vermogen om te innoveren in de buurt van de gebruikers, en een geïntegreerde aanpak van de financiering. Het proefschrift onderzoekt de PEBI financiering in India. Het platteland van India lijdt aan een gebrek aan financiële diensten, ondanks de overheidsprogramma's ter ondersteuning van 'sociaal bankieren'. Tegelijkertijd zijn kredieten op kleine schaal aan ondernemers en kleine bedrijven vermindert, wat suggereert dat bankkrediet niet heeft voldaan aan PEBI ondersteuning. Er is echter onlangs een alternatieve financiële sector ontstaan om PEBI te ondersteunen. Er zijn drie brede categorieën: 1) micro durf kapitaalfondsen die ondersteuning bieden voor ondernemingen een betere dienstverlening, producten of werkgelegenheid bieden voor de arme plattelandsbevolking, 2) kleinschalige financiële organisaties die verder zijn gegaan dan microfinanciering om landelijke boeren en ondernemers te ondersteunen; 3) organisaties die innovatie ondersteunen, hetzij door lokaal te innoveren, of als incubators voor de landelijke ondernemers en uitvinders. Het proefschrift bestaat uit vijf casestudies uit deze sector: Aavishkaar, Basix, S3IDF, Centre for Technology Development, en Villgro. De organisaties zijn complementair en vormen een ecosysteem van verschillende soorten van financiële steun. Ze nemen een geïntegreerde aanpak tot ondersteuning, met inbegrip van zowel financiële als niet-financiële ondersteuning. Zij benadrukken partnerschappen en netwerken voor een betere dienstverlening, verwerven deskundigheid om de sector zelf te beïnvloeden. Ze zijn flexibel en kunnen aanpassen aan nieuwe uitdagingen. Ten slotte, de organisaties sluiten aan met de banken in de kern, wat belangrijk is voor opschaling.